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Making FTAs more inclusive – A case for promoting SMEs in India

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Making FTAs more inclusive – A case for promoting SMEs in India¹

1. Introduction

The new-age production process is characterised by state-of-the-art technologies such as the artificial intelligence and internet of things. According to estimates, automation could eliminate up to 30% of jobs or an equivalent of 800 million workers by 2030 (MGI, 2017). The severity of the possible effect draws attention to SMEs (small and medium enterprises) as the most intensive source of employment. World wide, 162.8 million SMEs provide employment to 508 million workers (IFC, 2014). Moreover, SMEs are also important for other socio-economic reasons such as lower poverty and a more equal distribution of wealth. Thus, their growth and performance becomes critical to livelihoods of many people. In this research, I link-up their future prospects – post-pandemic and thereafter – to the benefits from addressing information asymmetries as part of FTA implementation, which leads to overseas demand expansion for them.

In India, MSMEs (micro, small and medium enterprises) contribute nearly half of India's exports to the world and 29% of the GDP. The Government of India envisions a much larger role for the SMEs with at least \$2 million in the \$5 million economy by 2024. Among the existing MSME exporters, most operate through export houses as also evident from a low proportion of registered MSME exporters. This highlights their limited or minimal knowledge of documentation procedures, and also the existence and nature of NTBs applicable on their products. Awareness on quality standards and regulations is crucial to diversify to other markets, and to minimise rejection of shipments. It is important for the exporter to understand the differences in markets and meet the standards as the requirements vary across different regions/markets. Much of this can be achieved through improved and transparent communication. Evermore, up-to-date information becomes indispensable as international governments become more protectionists in post-pandemic recovery.

The pandemic crisis has (further) enhanced the need for efficient logistics and connectivity. The slowdown in usual clearance procedures emphasizes on strengthening the ICT connectivity, digitization and re-coursing to ecommerce; making them absolutely crucial for business operations. It is noteworthy that the benefits of digital revolution for business, both SME and general, do not impose additional costs from internet connectivity.² This is in sharp contrast to the high costs associated with logistic improvements, which are even higher for developments in remote area. Since SMEs are more sensitive to disruptions in trade, an attempt to smoothen their international engagement through the trade channel also contributes to SDGs through better income opportunities in the lower quartiles.

In India, as many as three explicit interventions for the SMEs have been announced in the post-Covid recovery stimulus. These include the long pending revision in definition of MSMEs, emergency collateral-free credit, and the promotion of e-market linkages in the times of social distancing. However, revising the definition provides little help in creating demand. Post-pandemic, the recovery of SMEs faces the twin challenges from shrinking demand; and restricted

¹ This paper is a substantially revised version of the paper earlier contributed to the Policy Hackathon on Model Provisions for Trade in Times of Crisis and Pandemic in Regional and Other Trade Agreements, as an initiative in support of “building back better” after COVID-19, organised by the UN-ESCAP in collaboration with WTO and other organisations from civil society, academia, and the private sector. The permission by UN-ESCAP to publish the paper is duly acknowledged.

² Following the international parlance, hereafter, we use the term SME synonymous to MSME, unless explicitly stated.

supply of materials and inputs. In view of the few takers of the credit, the demand side fears appear to be more compelling. Thus, it becomes vital to facilitate and capture every market opportunity, domestic or international.

In fact, 'lack of market information' and 'lack of business contacts' have been two most export constraining factors reported by SMEs. Since most SMEs are devoid of a formal institutional structure, they are disadvantaged from the information asymmetries. For instance, large firms have dedicated resources for advertising, market research and developing/ enhancing distribution networks. In contrast, low scale of SMEs rules out such expenses. Therefore, efforts in sharing market information will be helpful in bridging their information deficit.

Often access to trade related information is considered easily acquired through digital sources. However, digital penetration in India, offers no room for complacency.³ With a comparably low internet penetration of the overall economy, it is not unfair to comment that SMEs, particularly the micro and small enterprises, are more severely constrained in their information access. Further, information even if accessible is not always adequately understood due to the complex nature of text and language issues. In fact, information deficit of SMEs forbids their direct participation in trade.

India's FTAs have remained sub-optimally utilized, with a failure to capitalize on its vast SME base. A dedicated support for SMEs through imparting information as well as addressing their concerns will not only improve prospects for SMEs, but will also contribute to greater utilization of the FTAs. My focus on strengthening cooperation on SMEs as part of India's FTAs is topical due to three main reasons: (i) the recovery from pandemic related crisis, (ii) in view of India's on-going FTA negotiation with Peru and expansion of the existing PTA with Chile, and (iii) the national government's announcement for post-Covid19 intervention to promote e-market linkage for MSMEs.

With the above backdrop, this contribution to the Hackathon draws attention to SME related provision in FTAs, particularly that of India. A case is made for due consideration to SME concerns in FTAs through better representation of the stakeholders. The paper is structured into eight sections. The following section presents profile of SMEs in India, establishes their importance and motivates research subject of the paper. Section 3 highlights information deficit as a major challenge for SMEs. Section 4 adopts a comparison of India's SMEs vis-à-vis other countries, and underscores the need to address the challenges faced. Section 5 introduces the possibility of demand expansion through SME engagement in trade. Section 6 brings together the problems faced by SMEs in improving their utilisation of existing FTAs. The SMEs related provisions in FTAs are reviewed in detail in Section 7 to make the case for inclusion in all future FTAs. Section 8 concludes by providing recommendations and implications in the Indian context.

2. SME landscape in India

The SMEs are a cornerstone of Indian economic structure contributing 28.9% to GDP and 31.8% to GVA.^{4,5} However, growth in the SME sector has slowed down over the past years from 15.2%

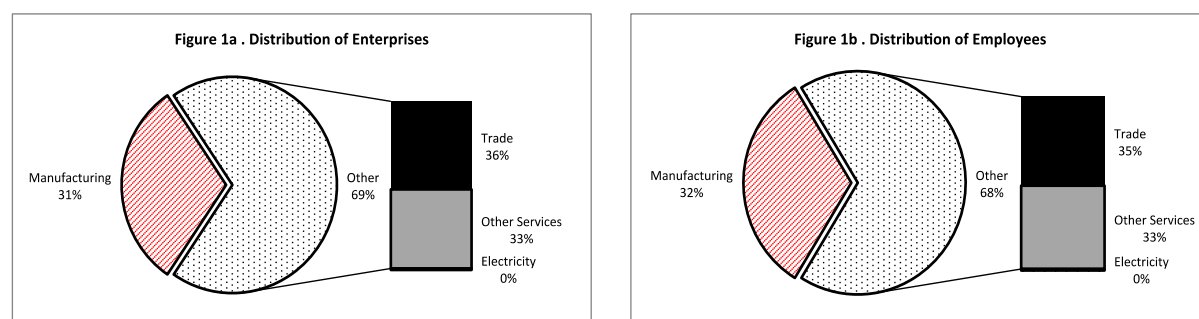
³ Refers to internet penetration in comparison to other countries. This is discussed in detail later.

⁴ The MSME Act, 2006 classifies MSMEs based on investment ceiling. A manufacturing MSMEs is classified as micro if the investment (measured in INR) in plant & machinery is up to 2.5 million, small-sized if investment is between 2.5 million and 50 million, and medium-sized if investment is between 50 million and 100 million. Service sector MSMEs are categorized based on the level of investment in machinery. These are categorized into micro if investment (measured in INR) is up to 1 million, small if investment is between 1 to 20 million and medium if investment is between 20 to 50 million. These definitions have however been revised with effect from 1 July 2020. The new composite criteria are based on investment in plant & machinery and turnover with common thresholds for manufacturing and services. The micro enterprises have

in 2012-13 to 9.4% in 2016-17. The deceleration of 63.39 million enterprises providing an employment of 111 million requires exercising policy prudence. This makes it necessary to not only to identify their existing challenges but also to devise newer ways to encourage their accelerated participation in the process of economic growth. A strategy for their revival, sustenance and growth cannot overlook opportunities of any kind, whether domestic or international. In fact, internal and external expansion of the SMEs is complementary in nature. While stronger performance in domestic market will foster their path to capture and participate in business opportunities abroad, success on the global platform will benefit through spillovers to domestic SMEs further enhancing their market prospects through market augmentation.

The composition of SMEs in India is highly skewed with a predominance of micro enterprises accounting for 99% share. Small and medium sized enterprises have an insignificant presence at 0.05% and 0.01%, respectively. The ownership is predominantly male, with four out of five enterprises under male ownership; although females have better representation in the micro enterprises. The geographical division of SMEs is relatively balanced between urban and rural areas, at the aggregate level and for the micro-sized enterprises. However, small and medium sized enterprises are mostly located in urban areas. The ownership is predominantly male, both in rural and urban areas.

Sector-wise distribution of SMEs has a service sector bias with almost double the representation of manufacturing. However, within services, nearly half of the SMEs are engaged in trade (Figure 1a). Although micro enterprises dominate both manufacturing and services, their share in service SMEs is higher at 89.8% compared to 84.9% of manufacturing enterprises being micro-sized (GOI-CII, 2018). Likewise, much of the total employment of 111 million in SMEs belongs to the non-manufacturing category (Figure 1b). Across activities, both within manufacturing and services, the micro enterprises dominate.



Source: GOI (2019).

Notwithstanding socioeconomic importance, the SME performance is constrained by domestic and international policy. Domestic policy refers to the inadequate attention, which is often directed to promotion of large business. The impact of international policy refers to the trade protocols in partner country, that are generally difficult to comprehend and adhere, as well as the standards compliance about which the domestic SMEs are either unaware, or find it difficult to comply due to technological requirements, or are unable to bear the associated additional costs.

More specifically, the setback for SMEs occurs primarily from limited access to finance and due to marketing problems. Despite availability of funds for disbursement, SMEs often fall short to meet the documentation requirements in the form of past performance and acceptable collaterals.

investment up to 10 million and turnover up to 50 million; small enterprises have investment and turnover caps at 100 million and 500 million, while medium enterprises have investment and turnover limits of 500 million and 2500 million, respectively.

⁵ Figures refer to latest available year of 2016-17 as sourced from GOI (2019).

Marketing information of an SME is constrained with the quality of manpower possessing competent skills for engaging in marketing networks. Due to low turnovers, SMEs find it difficult to attract/retain qualified and motivated personnel. Particularly the external barriers for SMEs include access to raw material and technology, and foreign competition. Each of these three is in turn limited by inadequacy of information and/or high costs of procuring information. Given its low market exposure and limited product profile, an SME is unlikely to be informed about the availability of alternate raw materials at lower prices from a partner country. The low scale of operations wards off technological adoptions and R&D activity, both of which involve high initial costs. Although (foreign) competition can drive productivity improvements, it inhibits performance in presence of information asymmetries. Other challenges of SMEs include infrastructure problems, IT capacity, lack of access to R&D, power shortages and high tax rates.

Critically of the information challenge for an SME is evident from a high proportion of large sized firms (42%) reported having faced difficulty in assessing information and benefits from government Covid-related SMEs programmes (ITC, 2020). The proportion of medium, small and micro firms reporting difficulty was even higher at 51%, 60% and 60%, respectively. In light of these survey responses it may be normal to expect even more severe constraints for SMEs while trading with international partners. Incidentally, the recent and increasing improvements in telecommunication can be helpful in lowering the information barriers for SMEs through digital channels. Therefore, digitization of information and its transmission appears to be a promising development for better and faster integration of SME into global trade. It has enormous potential to lower export costs of a typical SME by more than 80%. Time taken to export is also slashed by up to 29% through digital adoptions (GOI-CII, 2018). The benefits of digitization extend in many other ways. Digitally active enterprises grow profits up to two times faster and employ five times more than their offline counterparts (KPMG and Google, 2017).⁶ Digitization also widens the market scope as evident from more than half of the digitally enabled firms selling beyond their cities in contrast to less than one-third of their offline counterparts. Despite added advantages of digitization, penetration has been low albeit improving over time. A larger number of enterprises are offline (8%); while the proportion of digitally enabled and connected enterprises is 15% each. However, only 2% of the firms engage in online business activity. This is surprising when viewed alongside a doubling of the adoption of smartphone in the SMEs (GOI-CII, 2018). A substantial proportion (35%) of the offline firms is unaware of the benefits of digitization or constrained with digital skills (31%) (KPMG and Google, 2017).

There are two facts that motivate the research subject – the recent enlargement of the micro segment, and the issue of information deficit of the SMEs. It is noteworthy that employment expansion in both manufacturing and service SMEs has been lower than the expansion in number of enterprises. During the decade from 2006-07 to 2015-15, the number of enterprises grew at 6.4%, with a lower growth rate of employment at 3.6% (GOI, 2019). Growth divergence between number of enterprises and employment has been higher for manufacturing in comparison to services. This implies that most of the new entrants have been at the bottom of the pyramid i.e. micro-sized, where the employment-level is lowest, essentially due to self employed nature of the activity. Since, these enterprises are devoid of a formal institutional structure, they are likely to be disadvantaged from the information asymmetries. For instance, large firms have dedicated resources for advertising, market research and developing/ enhancing distribution networks. In contrast, the small scale of SMEs rules out such expenses. Therefore, efforts in sharing market information to the SMEs will be helpful in bridging their information deficit. Since the costs related to information procurement are largely independent of firm size, the costs involved will be nearly same for an SME and a large firm. However, SMEs are typically marked

⁶ Refers to small and medium business.

with low economies of operations reducing their profits per unit, leaving little room to accommodate such expenses which can be absorbed by large firms.

The lack of market information prevents SMEs from expansion opportunities both domestic as well as international. In fact, this is a possible reason for the low level of their direct engagement and undertaking sub-contacting activities. Access to market related information can essentially support the SMEs through – (i) better opportunities for output disposition, and (ii) awareness of alternate suppliers from abroad reducing dependence on existing suppliers. While the former has benefits through demand generation in the times of present crisis, the latter reduces the risks from future trade wars, protectionist policies, and supply erosion during pandemic like situations.

3. Information deficit and inadequacy of market network – A challenge for SMEs

The issue of market related information and network cannot be overemphasized in the SME context. In absence of an internal expertise and lack of resources to pay for an external advise/consultancy, the SMEs often face issues while venturing into new markets. This is corroborated from the findings of an export coaching programme (ECP) of the SMEs, including those from India, commissioned by the Centre for Promotion of Imports from developing countries. ‘Lack of business contacts’ and ‘lack of market information’ have been cited as the two most important factors reported by the SMEs for not exporting more to the EU (Vonk et al, 2014). The ECP was found effective in addressing both concerns as the number of respondents declaring the before mentioned constraints to be most important, declined considerably subsequent to intervention.⁷ Effectiveness of the ECP establishes the case for a focused support programme for the SMEs. Another survey of MSMEs highlights ‘finding a business partner’ and ‘market access’ as the top two constraints while also identifying ‘language’ as a limitation even while exporting through IT/ ITEs media (Future of Business Survey, 2017).⁸

A key aspect of SME growth performance is linked to improved market access, which in turn is dependent upon information about the markets, a severely constraining factor due to limited awareness. Furthermore, the unfamiliarity on issues such as legal and regulatory framework in the partner country markets, lack of awareness on IPR issues, unawareness of export supporting programmes of the government, inaccessibility to export distribution channels and overseas customers prevents SMEs from exploring international destinations and markets (Singh, 2019).

Due to their small size the SMEs are unable to specialize in many high-value product segments. However, the GVCs provide an opportunity to integrate into product chains. With GVCs commanding the new paradigm of international trade, the SMEs are provided with opportunities for expansion through active participation in trade. This can be achieved directly through supplying intermediate inputs to international markets, or indirectly through selling to domestic manufacturers of exports, the latter being a larger component in India (GOI-CII, 2018). SME advantage of the GVC model is due to the possibility of specialization in specific products which can help them focus on achieving better standards and adopt innovative practices, both soft and hard, within their domain. However, compliance with standards does not come easy due to lack of information and the additional costs imposed in the process. The knowledge deficit of an SME on the relevant standards is further widened due to their unawareness of the Ethical Trade Imperatives (ETI) that impose additional compliance burden through requirements such as those related to (not indulging in) child labor, observing work hours, health and safety of workers, wages and environment. For instance, convergence on labour standards is a pre-condition to resuming the negotiation talks on the India-EU Board-based Investment and Trade Agreement

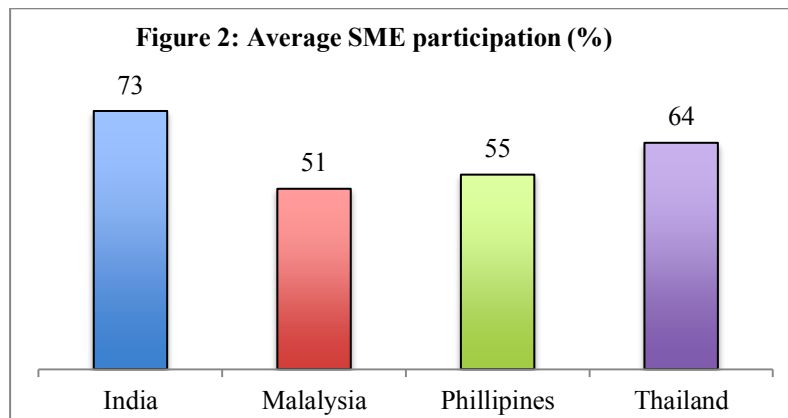
⁷ The responses on improvement do not necessarily correspond to those from Indian SMEs.

⁸ The survey covers SMEs from 33 countries including India.

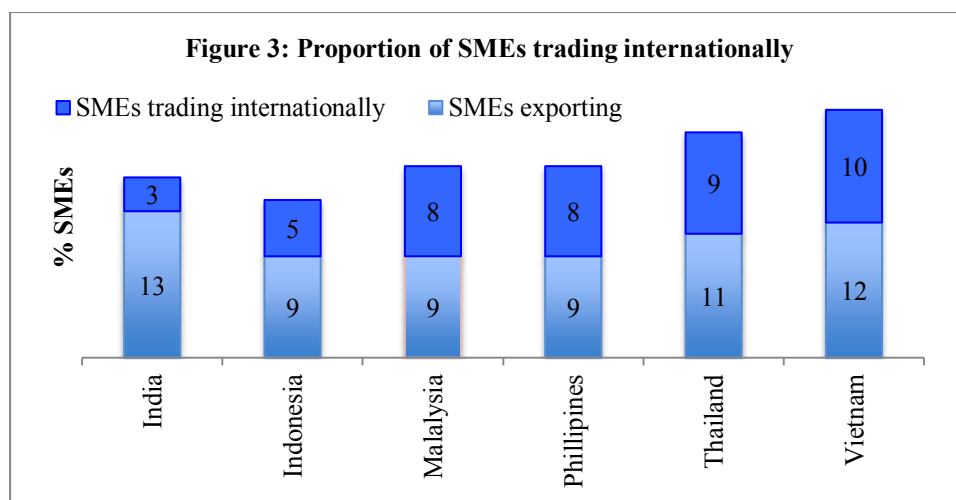
However, digitisation and access to information are necessary but not sufficient conditions for SME performance. Information should be communicated in a comprehensive manner with easy language and text.

4. Performance comparison of India's SMEs

At this point a comparative performance of India's SMEs vis-a-vis other countries is further helpful to assess the need for targeted interventions at home. For brevity, reasons of data availability and suitability for comparisons, a reference group comprising of ASEAN-4 countries namely Indonesia, Malaysia, Philippines and Thailand; and Vietnam along with India is considered here.⁹ India stands apart with the strongest presence of SMEs by comparison (Figure 2). However, India lags behind in internationalisation of SMEs. Globally, 19% of the SMEs are reported to trade internationally of which 6% SMEs trade through exports and imports, while 5% SMEs engage only through exports and another 8% SMEs involve only through import activities. By comparison, 16% of Indian SMEs trade internationally and 13% SMEs engage into export activities (Figure 3). International participation is low in comparison to most countries in the reference group.



Source: ITC (2019).

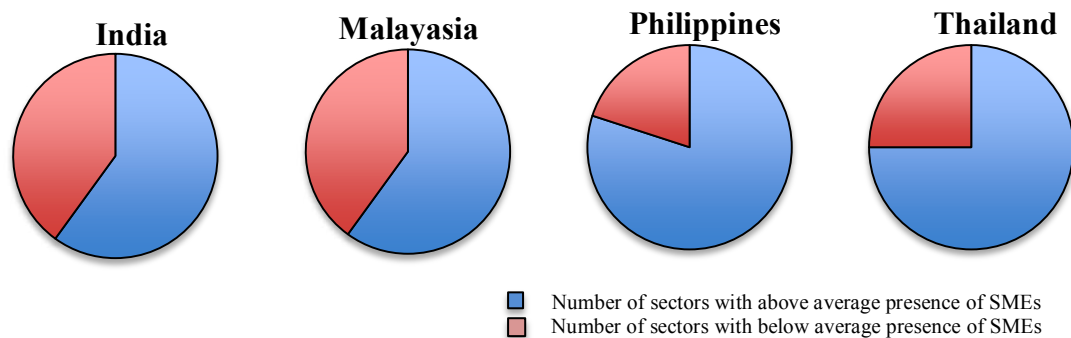


Source: Future of Business Survey (2017).

⁹ Whenever data is available.

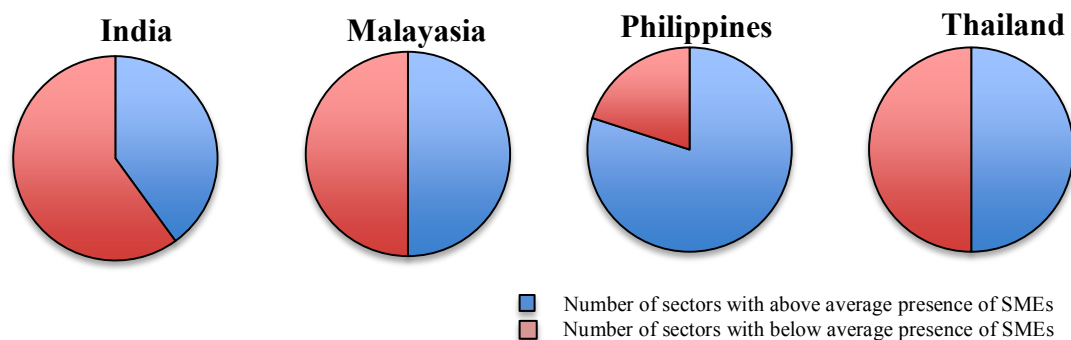
A relatively low level of SME participation in India is also inferred from the SME Competitiveness Outlook of the ITC. The assessment is based on projected supply chain losses in country exports (imports) to (from) G3 countries of China, EU and USA during the two-month Covid period industrial lockdown in 2020. The SME characteristics of 5 export sectors most severely impacted from the disruptions have show a relatively weaker representation of sectors with above (national) average SME presence (Figure 4). Similarly, in India a lesser number of sectors among the top 5 most impacted importing sectors have an above average SME presence (Figure 5).

Figure 4: SME characteristics of top 5 severely impacted exporting sectors from Covid industrial lockdown



Notes: The charts represent proportion of sectors among top 5 top sectors with above (below) average SME presence.
Source: ITC (2020).

Figure 5: SME characteristics of top 5 severely impacted importing sectors from Covid industrial lockdown

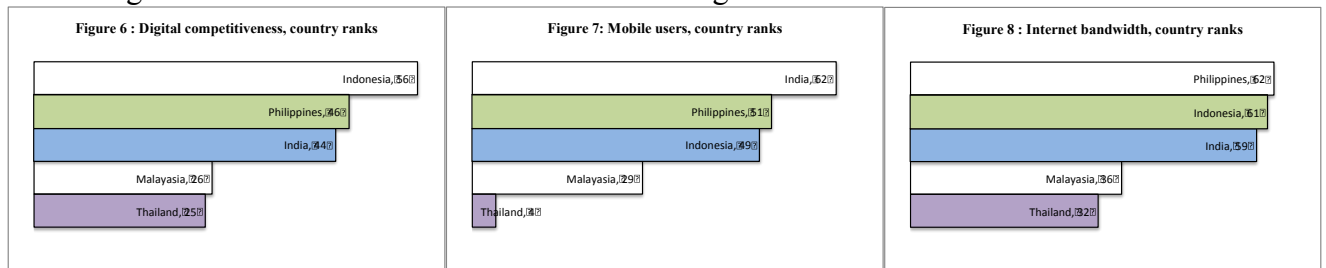


Notes: Same as Figure 4.
Source: Same as Figure 4.

Explicit and detailed international comparisons of SMEs for a large number of countries are scarce in number. At times, the available comparisons are based on aggregate indicators in the economy, and not specific to SMEs. Nevertheless, these are helpful to highlight the gaps, which are likely to be more biting for SMEs in particular. The World Digital Competitiveness Index ranks India 44th among 63 countries, placing it among the bottom one-third countries with low digitisation (Figure 6) (IMD, 2019). Comparative performance is even worse when viewed for number of mobile broadband subscribers and internet bandwidth speed, where India ranks 62nd and 59th, respectively (Figures 7 and 8). As a leading software giant, India’s lower digital integration reflects upon a dual economy structure, certainly not an encouraging observation (ESCAP, 2020).¹⁰ Regional digital integration measure for India is the lowest within the reference group, as also is reflected through a much lower number of online purchases made.

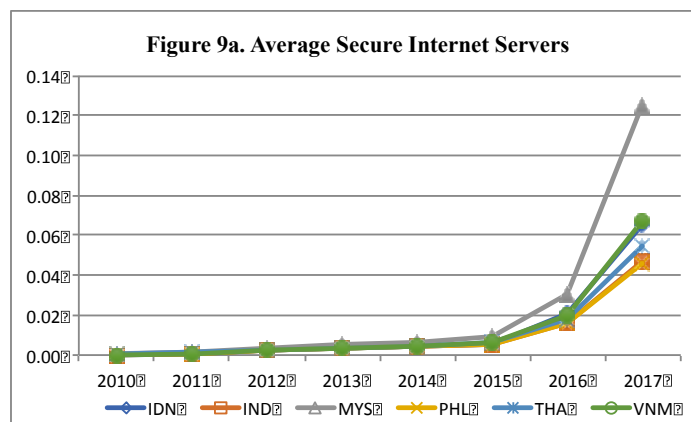
¹⁰ Refers to integration in the Asia-Pacific region. ESCAP (2020) provides index values and ranks on specific indicators.

Also, the lack of coherence in digital policy with the regional partners tends to be limiting integration for India with other countries in the region.



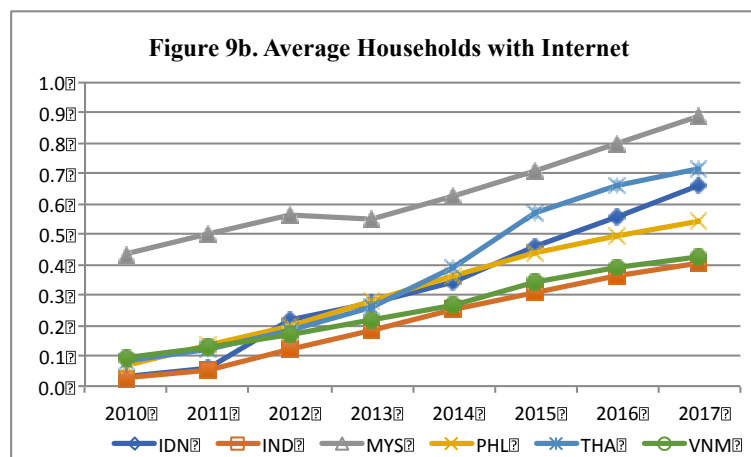
Source: IMD (2019).

Two more indicators of the relatively low regional integration of India's digital economy are reflected in the index based on number of secured servers and the number of households with internet access (Figures 9a and 9b). A typical SME has a pattern of digital engagements, which begins with online search, followed by online banking and then adoption of online sales (GOI-CII, 2018). Low levels of digital integration and digital adoption highlight limitations of the entrepreneurs in accessing and understanding international markets independently and on their own. The problems are further aggravated if the information, even though available online and accessible, is not in local language and uses legal text.



Notes: Figures represent index value.

Source: ESCAP (2020).



Notes: Figures represent index value.

Source: ESCAP (2020).

India also scores unsatisfactorily (by comparison) on the SPS and TBTs and technical cooperation index (ESCAP, 2020). This only emphasises the need for ~~intervention through~~ sharing information on conformance to standards and technical requirements for products to be acceptable in the destination country. The SMEs, in particular, are not only constrained with their low or insignificant awareness and knowledge of these issues, but are also out-beaten due to absence of networking with potential buyers abroad. A connection with the customers can also assist them through information on products.

A low regional integration on non-tariff measures – technical co-operation and digitisation – highlights the problems of business. Given the relatively less endowed nature of SMEs, it is not unreasonable to argue that they are more severely impacted from the existing low levels of awareness and understanding of the requirements. This in turn keeps them at arms length from engaging in trade.

5. Need to manoeuvre SMEs for trade participation

For a long time, the SME thresholds in India have been based on investment in plant & machinery. Crossing the caps would amount to losing the benefits – in the form of loans under priority sector lending schemes, 25% reservation in procurement of the government and government-owned companies, permission to participate in bid for stressed assets, government reliefs from time to time, and at the time of crisis such as under the present conditions. Fearing disqualification to available benefits, enterprises believe “the small the better”. In an attempt to address the fear while also adopting a uniform assessment across manufacturing and services, a revised definition is effective July 1, 2020. The new definition is expansive in nature as it brings larger firms under the SME ambit. More firms qualify under the micro category than before. Although this entitles the benefits to a greater number of firms, the problems of the enterprises at the bottom are likely to remain. As the new entrants at the top have relative an added cost advantage, this is expected to crowd-out the already stressed micro-sized firms. Also, the merging of relatively bigger firms into the SME segment will accentuate intra-group competition, posing survival threat to those left at the bottom. Thus, handholding becomes essential.

Incidentally, a broader definition of the SMEs helps larger firms benefit from government schemes but fails to assist in demand expansion by addressing the existing challenges of information deficit and lack of awareness. The SMEs require maneuvering for greater integration through exposure and competency. While exposure can be achieved through information exchange, competency must be developed through training programmes. Here, the SME specific provisions in the FTAs will be instrumental through improving awareness, information and access. The small size prevents scaling-up of operations, a requirement for expansion of production. Resulting low level of profits prevent domestic R&D which could have led to gains from product heterogeneity due to design development.¹¹ Participation in trade with an FTA partner will broaden their market access.

6. Improving trade utilisation of PTAs through engaging SMEs

India’s utilisation of PTAs has been low, for exports and imports, with the partners. Exports with partner countries account approximately for 35% of its exports to the world, against a much larger share of imports from partners at nearly 50%. While import utilisation of the PTAs is comparable to the average (51%) for the Asia-pacific region, export utilization is far below the

¹¹ Here, design development refers to soft R&D which does not require core R&D activity. To illustrate, a slight modification in product design, such as in case of apparels through introduction of elbow patches, pockets, attached hoodies, improve product variety.

regional average of 44% (Anukoonwattaka and Lobo, 2019). Thus, India's trade agreements remain underutilised, more on exports creating sceptics for future trade agreements.

Only a fraction of SMEs trade internationally, of which nearly half find it challenging to sell in foreign countries (Future of Business Survey, 2017).¹² It is important to catapult their participation in the export basket. Due to their low levels of investment, the SMEs present a low-risk opportunity to go global. A potential problem of the SMEs, particularly in the pandemic like situations, is the lack of demand. A demand crisis prevents returning to an uninterrupted business cycle. In view of the recent demand contraction, demand revival through real-time information on global demand patterns cannot be overemphasised. This is particularly important for SMEs, as they are likely to be left behind with low level of digitisation and subsequently inadequate information on issues of foreign market and compliance requirements. The need dovetails with the recently announced initiative by the Indian government to promote e-market linkages for SMEs in the post-Covid period. In view of the social distancing norms, the Indian government has proposed using e-market linkages as replacement to trade fairs and exhibitions (GOI, 2020).

Market research activity is focussed in nature requiring dedicated resources in terms of time and cost, collectively referred as sunk costs. The associated costs are independent of firm-size, thereby implying the costs are higher in proportionate terms progressively for micro, small and medium sized firms (Caves, 1989). Direct information on the export markets in the form of consumer tastes, market competition and distribution network, reduces the sunk costs for potential exporters. The information spillover to non-exporters will additionally encourage domestic producers into export market, at no additional cost. SMEs in many developing countries such as Latin American region, Iran, Jordan, Nigeria and Sri Lanka face a common problem of lack of market information abroad.¹³ SMEs in India have been no exception and have been constrained with lack of market information obstructing them from exporting to the regions such as the EU (Vonk et al, 2015). The experience of US manufacturing SMEs is no different as noted from the difficulty in locating sales prospects abroad (USITC, 2010).

The SMEs are likely to benefit differently from the large business through improvement in trade facilitation measures, and enhanced information technology services (Li and Wilson, 2009; WTO 2016). Also, importance of better IT services for the SMEs is further reinforced due to the relatively severe constraints with their inadequately educated labour force (Duval and Utoktham, 2014). Due to lower scale of economy and insufficiently educated labour force, the burden of information barriers is relatively more on SMEs (compared to the large business). The lack of awareness as well as advocacy expertise, essentially due to their fragmented size, prevents their participation in trade. The limitations on capacity of small and micro firms in understanding of the process and regulations for complying the rules of origin has been acknowledged for the small and micro firms in UK (Department for International Trade, 2019). In fact, the impact assessment noted that the firms may choose to opt out from trading under the FTA due to high compliance costs, and may benefit from trading under the MFN baseline thus avoiding extra cost burden. The SME disadvantage due to cost and loss of time from the product and process adjustments in TBT compliance is also noted in the context of the EU-Vietnam FTA (Delegation of the European Union to Vietnam, 2016). Further, language barriers and technical nature of the NTB content contributes to discomfort and inability in engaging into trade (Fliess and Busquets,

¹² Refers to overall findings, which include responses from SMEs in India.

¹³ Refer WTO (2016) for an excellent summary of surveys on the issue of SMEs and RTAs. The OECD (2005) report covered 30 SMEs in Latin American Integration Association, Kabiri and Mokshapathy (2012) surveyed 76 SMEs producing fruit and vegetables in Tehran; Al-Hyari et al (2012) surveyed 135 Jordanian manufacturing SMEs, Okpara (2009) surveyed 72 manufacturing SMEs in Nigeria, Gunaratne (2009) undertook a postal questionnaire survey of SMEs in Sri Lanka, OECD (2008) surveyed 978 SMEs' perception of the barriers to their internationalization across 47 countries.

2006). Siringoringo et al (2009) underscore the importance of providing training and information to the SME managements to overcome the barriers to exports.¹⁴

The sunk costs have a key influence on export participation (Siannai and Hobdari, 2006). Literature also provides evidence on information costs as trade barriers (Anderson and Wincoop, 2004). Since information costs are independent of the value and volume of trade, the costs are proportionately high for SMEs due to low volumes. Lack of network in region also prevents information access about export markets and regulations. At the same time, firms in the partner country may not be able to connect to the locally producing SMEs that operate under informality. Therefore, connecting the two through business fairs could go a long way in enhancing their mutual access. This will also help in GVC integration of the domestic SMEs through participation in production networks abroad.

Another disadvantage occurs from the cost of exporting which includes expenses on account of freight, insurance, warehousing, and the penalties imposed due to delay in receipt of goods. Under the traditional system of trade clearance, communication related to evidence of contract of carriage, receipt of goods, and document to title of the goods, is handled through the Bill of Lading (B/L) on physical paper duly signed and stamped by the carrier. However, exporters and importers face problems in delivery and receipt if the B/L reaches late. This adds to the cost burden from insurance and warehousing charges incurred over longer periods. Further, extended waiting time at the port sometimes also results in removal of the container by importing country adding to demurrage. In some cases, damages occurring in products with shorter shelf-lives, contribute to costs and losses, lowering entrepreneurs' profit. In a survey, more than one-fifth of the SMEs reported 'costs of exporting' as an important reason for not exporting more (Vonk et al, 2015). An already limited pool of knowledge resources to manage documentation along with the low value of parcels makes it uneconomical for SMEs to trade. The effect can be mitigated through implementing paperless trade systems.¹⁵ Past evidence shows that implementation of paperless and electronic single window systems contributes through substantially lower border processing time and cost (90% and 60%, respectively, as noted for Senegal) and increased value of trade (2% of exports as noted for Costa-Rica) (Martincus, 2016).¹⁶

7. SME related provisions in trade agreements¹⁷

Participation of SMEs in trade can be improved and strengthened through focussed interventions. Provisions specific to SMEs will be helpful. With this view, a review of the related provisions in the existing agreements provides useful leads through the mechanisms used to – (i) address existing shortcomings, and (ii) benefit from specific features in the modern-age agreements. Therefore, specific agreements or treaties have been reviewed in this section for their approach on SMEs. All agreements with India as a participating country and having SME provisions have been included (Table 1).¹⁸ Also keeping the Indian context in mind, existing agreements of the two prospective future partners with which India is currently engaged for (re-)negotiations – Chile and Peru – are also studied. SME provisions in agreements with Vietnam as a partner country are of particular interest due to SME predominance in the economy. Hence, they are included for study. Additionally, two major trade agreements – CPTPP and NAFTA – are reviewed. Furthermore, the recent EU-Vietnam FTA is among the new generation agreements, and is included along with two more modern-date agreements. The SME related provisions in

¹⁴ Their study is based on survey of SMEs in Indonesia.

¹⁵ Benefits will accrue to non-SMEs as well.

¹⁶ Information for Senegal as quoted in WEF (2017).

¹⁷ Information on FTAs is sourced from SICE and WTO Websites.

¹⁸ All trade agreements have been scanned, however only the ones having SME provisions have been tabulated.

RTAs are generally categorised into provisions for cooperation, exceptions/exemptions and transparency. However, reference to SMEs has also been made under other clauses.

The India-ASEAN FTA identifies SMEs as an area of cooperation. Cooperation can be sought 'where appropriate' for human resource development, training in IT and ICT, however it is not obligatory. The India-Japan CEPA also identifies SMEs as a field of cooperation. India-Nepal treaty offers levy parity of additional duty on products manufactured in small units in Nepal subject to certification by the Nepal government on their production in small-scale units. India-SAFTA has provision for export promotion of SMEs engaged in production for exports in the least developing country partners through support for technical, managerial and skill technical support and entrepreneur skills. India-Korea FTA recognises the fundamental role played by the SMEs and provides for cooperation through facilitating investment flows, collaboration or sharing of best practices in the fields of management, skill development, technology transfers, and access to finance and technical assistance. In addition, support can be sought through organising fairs and exhibitions. Also, sharing the development and experience on SME policy is encouraged in the agreement. Prior government permission is required for investment of the more than 24% foreign equity in small-scale units manufacturing items reserved for the small-scale sector. It also clarifies that a unit with more than 24% foreign equity will not be eligible for government benefits. India-Malaysia FTA also affirms importance of all forms of cooperation on SMEs to be identified and discussed by a sub-committee on economic cooperation. India's agreement with Thailand, having a partial scope, provides for cooperation on SMEs. However, many other agreements with India as a member such as the APTA, GSTP, SAPTA and those with Afghanistan, Bhutan, Sri Lanka, MERCOSUR and Chile are silent on SMEs.

With regard to Chile's trade agreements, the Chile-Vietnam FTA provides for SMEs under areas of cooperation and capacity building (Chapter 9). The mega block CPTPP, of which Chile is a member, has a dedicated chapter for SMEs stating that each member shall self-establish or self-maintain a website with the information on agreement, including information designed for SMEs. The agreement has provision for instituting a 'Committee on SMEs' to apprise the benefits of the agreement, facilitate programs for their development and integrations global supply chains, and provide information for monitoring the relevant implementation of the agreement. Article 24.1 2(b) of the CPTPP mentions 'endeavour' to provide, in English, the information that could be of relevance to any person interested in trading, investing or doing business in the member country. The Chile-China agreement (and also the Peru-China agreement mentioned later in the discussion) has provisions for cooperation on SMEs through exchange of experiences, design and development of mechanisms for productive linkages and partnerships, development of human and managerial skills for better understanding of mutual market, improving information access regarding mandatory procedures, and programmes related to technological transfer for productivity improvements. The cooperation mechanism includes information exchange, conferences and export dialogues, and networking through promoting contacts, workshops and programmes. The agreement with EU provides for cooperation to improve understanding of the government procurement procedures for better market opportunities. The FTA with European Community seeks cooperation on SMEs through promotion of information networks, financial assistance and innovation, as also in the area of social cooperation through employment generating programmes for SMEs. The Chile-US agreement provides for establishment of a committee on procurement that may ask the partner support for trainings and assistance for government procurement process. The SME problems of e-commerce are recognised. The Chile-Australia agreement provides for information exchange to maximise SME access to market in government procurement. Chile's FTA with Brunei Darussalam, New Zealand and Singapore encourages cooperation among the members to

promote English language as a tool for SME. Chile-Columbia FTA has cooperation provisions to overcome the obstacles faced by the SMEs from ecommerce in addition to economic cooperation through trade facilitation and investment. The recent CEPA between Chile-Indonesia, effective August 10, 2019 encourages and facilitates SMEs as a basic principle through cooperation on SMEs under necessary and appropriate conditions. These provisions are in sharp contrast to the existing Chile-India FTA, which completely abstains from a specific provision for the SMEs.

Among the trade agreements to which Peru is a signatory, the Peru-EU FTA recognises and agrees to work on SME participation in government procurement through facilitating information exchange. The Peru-Japan FTA provides to establish a sub-committee for procurement with special attention for SMEs, including microenterprises. In article 14.9 of the Peru-Korea FTA, on cooperation in ecommerce, there is a specific mention of the SMEs and facilitating their use of ecommerce. Recognising the importance and need of the SMEs, another article endeavours information exchange for their engagement in government procurement. In addition, the chapter on cooperation also endeavours particularly to SMEs for exchange of information and experience, development and use of electronic communications in government procurement, and trainings of SME exporters. Like-wise to the FTA between China and Chile, the Peru-China FTA attempts to strengthen exchanges on many fronts as elaborated before. Similar to the Chile-US FTA, a committee on government procurement set up under the Peru-US FTA provides to ask the partner country for trade related assistance or training of government officers of interested parties, especially for small business suppliers. Quite uniquely, the FTA provides for cooperative work on labour and capacity building by specifically addressing SMEs issues related to prompting working rights, improvement in working conditions and productivity, public awareness related to laws. There is also a provision of a Free Trade Commission, to review the impact of agreement on SME and seek their views and inputs.

Vietnam, an ASEAN member, is party to many agreements. The ASEAN-New Zealand-Australia FTA has provisions for assisting SMEs on obstacles encountered in ecommerce. The ASEAN-China FTA agrees to explore and undertake economic cooperation activities on SMEs for mutual benefit as also in the ASEAN-Japan CEC. Article 3 of the ASEAN-Korea FTA encourages the parties to develop and implement programmes to benefit SMEs, among others. The Vietnam-EAEU FTA endeavours cooperation on SMEs through facilitation of suppliers in government procurement. Vietnam-Japan FTA provides for cooperation on SMEs as considered necessary and appropriate.

Table 1: SME related provisions, select trade agreements

S.No.	Partner country	Nature of agreement	SME related provisions	Level/ Scope of commitment
<i>India as a partner country</i>				
1	India-ASEAN	FTA & EIA	Article 6, Annex C	Agree to strengthen cooperation, wherever appropriate
2	India-Japan	FTA & EIA	Article 129	Mutually agreed basis, subject to the laws, regulation and availability of funds
3	India-Korea	FTA & EIA	Article 13.5, Annex I	Expression of intent through use of "shall" in the text
4	India-Malaysia	FTA & EIA	Article 11.2	Expression of intent through use of "shall" in the text
5	India-Nepal	PSA	with reference to Article V	Conditional to certification
6	India-SAFTA	FTA	Annex II	For promotion of SMEs engaged in production for exports
7	India-Thailand	PSA	Article 6	Expression of intent through use of "shall" in the text
<i>Chile as a partner country</i>				
8	Chile-Australia	FTA & EIA	Article 15.24, 18.2	Possibility of cooperation on SMEs as expressed through use of "may" in the text
9	Chile-Brunei Darussalam, New Zealand and Singapore	FTA & EIA	Article 16.4	Encourage and facilitate, as appropriate
10	Chile-China	FTA & EIA	Article 109 under Chapter 13	Expression of intent through use of "shall" in the text
11	Chile-Columbia	FTA & EIA	Article 12.5, 19.1 ^{&}	Recognition of importance
12	Chile-EFT*	FTA & EIA	Article 67	Endeavour to the extent possible
13	Chile-European Community	FTA & EIA	Article 19,44	Promote a favourable environment
14	Chile-Indonesia	FTA	Article 9.1, 9.4	Where necessary and appropriate, and in accordance with the respective laws and regulations
15	Chile-Malaysia	FTA	Article 9.3	Strengthen cooperation in others parts of the Agreement
16	Chile-US	FTA & EIA	Article 9.18, 15.5	Ecommerce
17	Chile-Vietnam	FTA	Article 9.3	Complement cooperation in others parts of the Agreement
<i>Peru as a partner country</i>				
18	Peru-China	FTA & EIA	Article 155 under Chapter 12	Promote a favourable environment
19	Peru-EFTA	FTA	Article 7.29, 7.30	Endeavour cooperation
20	Peru-Japan	FTA & EIA	Article 166 under Chapter 10	Cooperation on mutually agreed terms
21	Peru-Korea	FTA & EIA	Article 14.9, 16.17, 16.18, 20.4	Endeavour in recognition of the importance

S.No.	Partner country	Nature of agreement	SME related provisions	Level/ Scope of commitment
22	Peru-US <i>Vietnam as a partner country</i>	FTA & EIA	Article 9.15, 17.6, 20.1	Endeavour in recognition of the importance
23	ASEAN-China	FTA & EIA	Section D	Agreed to explore and undertake, on the basis of mutual benefit
24	ASEAN-Japan	FTA	Article 53	Subject to availability of resources, and in accordance with their respective laws and regulations
25	ASEAN-Korea	FTA & EIA	Article 3	Expression of intent through use of "shall" in the text
26	ASEAN-New Zealand, Australia	FTA & EIA	Article 9	Expression of intent through use of "shall" in the text
27	Vietnam-Eurasian Economic Union (EAEU)	FTA & EIA	Article 10.1	Endeavour
28	Vietnam-Japan	FTA & EIA	Article 111	Where necessary and appropriate, and in accordance with the respective laws and regulations, subject to availability of funds
<i>Mega block agreements</i>				
29	CPTPP*	FTA & EIA	Chapter 24	Endeavour
30	NAFTA	FTA & EIA	Article 1021 under Chapter 10	Expression of intent through use of "shall" in the text
<i>Recent/ new generation agreements</i>				
31	Australia-Hong Kong	FTA	Article 11.1, 16.6	Expression of intent through use of "shall" in the text
32	EU- Singapore	FTA	Article 6.6, 13.2	Expression of intent through use of "shall" in the text
33	EU-Vietnam	FTA	Article 4.5, 10.4, 14.1, 16.2	Expression of intent through use of "shall" in the text; where appropriate

Notes:

& Information from SICE

* EFT includes Iceland, Liechtenstein, Norway and Switzerland

CPTPP includes Chile, Vietnam, Peru as partners

FTA & EIA: Free Trade Agreement & Economic Integration Agreement

PSA: Partial Scope Agreement

1. India, Chile, Peru and Vietnam are partner to 18, 31, 22 and 13 trade agreements, respectively. However, the table shows only the ones, which have an SME relevant provision. The author has endeavored not to otherwise miss any specific RTA of these partners as on 26 Jun 2020,

2. Initial information on SME related provisions in RTAs of Chile and Peru is sourced from SICE, and the text of corresponding agreements has been screened for details.

Source: Compilations based on information collected from RTA database and SICE.

The NAFTA, among early trade agreements, in its Chapter 10 of the agreement text has provisions for SMEs in government procurements, development of database for use in partner country, and consultations regarding eligibility criteria of SMEs for participation in business programmes. Among the recent agreements, the FTA between EU-Singapore effective November 21, 2019, calls for simplification of trading procedures, both export and import, increasing their transparency and efficient to reduced business and improve predictably, including the SMEs. The move is attempted to reduce costs and improve predictability of business for the SMEs. The Australia-Hong Kong FTA that came into effect on January 17, 2020 also has provision for transparency and cooperation on SMEs through establishing or maintaining websites with information designed for SMEs. The new-generation FTAs such as the EU-Vietnam FTA also aim easy access for SMEs creating stability and trust for business.^{19,20}

In addition to explicit provisions on SMEs, an increasingly high number of FTAs provides for trade facilitation through digital measures to enhance trade opportunities. Although digitization measures attempt for paperless trade administration and are relevant to all business, the resulting reduction in trade costs (directly from faster movement and indirectly from expedited documentation) can be particularly encouraging for SMEs. It is noteworthy that a significantly high proportion (65%) of FTAs signed after 2005 include provisions for paperless trade measures (Duval and Mengjing, 2017). More than a fifth of these contain dedicated provisions for digitisation. While typology of the measure (e.g. acceptance of e-copies, e-submission and processing, e-system of SPS certificates, etc.) and the nature of provision (binding, non-binding) has varied across FTAs, the role of paperless trade in enhancing opportunities, including for SMEs, has been increasingly acknowledged. India is also noted to have included provision for measures related to paperless trade in select FTAs. However, the approach has been less aggressive compared with other countries such as Australia and New Zealand. While vouching for transparent and comprehensive digital information sharing, provisions for paperless trade would also be helpful for SMEs due to benefits from dematerialising of trade documentation. The adoption of paperless trade is marked with challenges due to varied level of implementation across countries, weaker IT infrastructure, lower IT capacity, differential legislations regarding validity of electronic signature and electronic documents, and data-regulation policies. Here also, the SMEs are more disadvantaged due to low IT capacity and limited/ slow digital access, further preventing them from maximising on the intended benefits from going paperless and digital.

To sum up, the most common form of an SME provision is through the inclusion of a clause for cooperation on SMEs. In some cases, the stated areas of cooperation include technical support, capacity building, information exchange, facilitation in access to government procurement, trade promotion, networking, and training and exchange programs for the SMEs. There are also provisions for sharing regulatory

¹⁹ News European Parliament accessed at <https://www.europarl.europa.eu/news/en/headlines/economy/20200131STO71518/eu-vietnam-trade-deal-what-are-the-benefits>

²⁰ The attention paid to SME interests in UK is noteworthy. An impact assessment, conducted prior to the recent BREXIT noted that UK based small and micro firms would suffer disproportionately to large business due to higher fixed costs involved in complying the role of origin criteria.

framework and best practises among the parties. Additionally, some FTAs provide for use of ecommerce particularly for SMEs. Certain FTAs include trade facilitation measures such as the clear and transparent customs procedures that take into account specific needs of the SMEs. Some FTAs also include cooperation on investment between the SMEs of the partner countries through investment promotion and facilitation. Intellectual property provisions in some FTAs encourage the development of IP including the SMEs (APEC, 2019). Also, inclusion of digital measures for trade facilitation in India's FTAs has been relatively limited, indicating greater scope in future.

8. Conclusions and policy recommendation

The pandemic has taught an important lesson for diversification of economic relations to mitigate risks from disruptions in production chains due to sudden global shocks. Post-pandemic, the recovery of SMEs faces the twin challenges that arise from shrinking demand, and restricted supply of materials and inputs. In view of the few takers of the relief package announced by the Indian government for the SMEs, the demand side fears appear to be more compelling. Thus, it becomes vital to facilitate and capture every market opportunity for the SMEs, domestic and international. The existing low level of resources and scale of operations, and low availability of skilled manpower in the SMEs sector prohibits their self-initiation into international business. However, specific provisions, if drafted into the existing trade arrangements can be helpful for SMEs through their involvement for better demand prospects. Additionally, this will support their international performance even after the "building back better" times for international trade.

Although the existing provisions in trade agreements are applicable to SMEs as much as to other business, in many agreements there have been explicit provisions for SMEs. However, the cooperation mechanism is not always detailed, explicit and elaborate to bring about a notable change through greater SME engagement in trade exchange.

Factors motivating exports include product demand in external market. However, domestic producers' ability to align with consumer preferences while also conforming to the standards requirement is dependent upon information access. The information asymmetry is a major challenge for the SMEs, which do not have sufficient internal resources to explore export markets or connect with sellers in partner countries for their import requirements. As a result, the SME participation in trade remains disproportionately low in proportion to their large number of enterprises. Consequently, the FTA utilisation also remains sub-optimal. The SMEs below a productivity threshold and scale of operation are unlikely to independently engage into activities related to study and identification of international markets, understanding consumer references and adapting to the standards practiced. These tasks entail sunk costs prohibiting their export participation. Providing information access will support market expansion for the SMEs that are otherwise unaware on a multitude of issues such as standards and labelling requirements, and roles of origin. These matters are complex and often the limited/ absent knowledge keeps SMEs at arms length from participating in trade.

In recognition of the contribution of SMEs to employment, output and exports, the Indian government has expressed deep interest to harness their potential through

stronger participation in the exports. This scaling up can be effectively achieved through carefully drafted provisions in FTAs addressing the existing information deficit on market and network challenges of the SMEs. Even though such information is available online from the government portal and accessible through web-navigation; the language barriers, and the legal and technical nature of the text lowers usefulness and effectiveness. Therefore, trainings, workshops and seminars in presence of the representatives from partner countries will be helpful in lowering the barriers of basic information for the entrepreneur. An interactive session will also help in creating a trust factor of the parties. With forethought for bringing the domestic SMEs in close contact with the government and business in the partner country, following recommendations may be considered for future FTAs.

1. Incorporation of a dedicated chapter for the SMEs. The text of the agreement should ‘mandate’ knowledge and information sharing along with the business contacts which would be of relevance to SMEs. Sharing information on compliance standards will be helpful to make SME stakeholders ‘aware’ and ‘prepare’ better. This will not only improve their market penetration through better standards conformance but will also enhance their prospects by outperforming third-party countries that default on standards.
2. The distinct needs of SMEs need to be honoured through clauses specific to their needs. Mandating the constitution of an SME body (in the form of a committee or commission with members from the partner countries) is a foremost requirement. The commission should necessarily have stakeholder representation from each segment within the SME sector for an effective and two-way exchange of propositions to address the concerns and challenges, and discuss future prospects. The commission should at least meet at pre-determined frequency and act on a time-bound basis to address the issues of stakeholders.
3. The commission should provide the means to bolster the interests of SMEs and address their concerns in a continued manner.
4. It would be more effective to mandate specific SME related provisions, as mere endeavours may not necessarily pay off.²¹
5. Mandating the partner country to provide, in English, the information relevant to SMEs such as contact information of relevant government and business agencies, taxation procedures, business regulations, standards and regulations, and empirical trade imperatives. Co-operation should also be mandated to translate the text with minimal use of legal and technical language. The home country can then translate the same for local communication.
6. Streamlining the product standards and certification requirements through a protocol on conformity assessment for products of SME origin will be of immense assistance.
7. Mandatory co-operation in the FTA through involvement of the SME representation in the assessment of impact of NTBs on SMEs will be helpful in standard setting. This will improve their ability to engage in mutual trade.
8. Increasing the visibility of SMEs through mutual co-operation for supporting their participation in trade fairs and exhibitions. The presence in a group venture alongside large firms will help SMEs gain confidence and exposure while adding to their information and ideas. This will shorten their arms-

²¹ A similar suggestion to make the availability of information obligatory is stated in the UKTPO report authored by Jaeger and Borchert (2020).

length relationships and will contribute to their business-socialisation in the partner country.

9. FTA Provisions for adoption of digital measures for paperless trade as means of trade facilitation will support to SMEs through lower costs. Additional support through flexible, co-operative and easier mechanisms for SMEs are required.

In fact, recommendations in the present work are being proposed at a turning point for the Indian economy with concurrence of the following events – (i) post-pandemic recovery period, which is particularly crucial for survival of the SMEs; (ii) on-going FTA negotiations and re-negotiations with Peru and Chile, respectively; and another one being considered with EU, and (iii) recently announced domestic government initiatives (e.g. e-market linkages) to prepare and strengthen SMEs for greater participation in the production network. It is important to negotiate on the interests of SMEs so that they can benefit from the margin of preferences under the expanded FTA with Chile, which is under consideration. These are likely to benefit enterprises in agricultural products, organic and inorganic chemicals, plastics and rubber products, textiles, apparel, articles of iron and steel. The under-negotiation FTA with Peru is expected to benefit producers of auto-components, iron and steel products, among others. Both countries have paid attention to the SMEs in their FTAs with other partners. However, the existing India-Chile FTA, which is being re-negotiated for an expansion, is silent on SMEs in the existing format.

The recommendations will have implications in the following key ways:

1. Improved information access for the SMEs will offer relief on business development efforts, and the resources can be diverted to other productive activities such as products and services, R&D and innovation. Even though the beneficiaries are likely to be the firms located at top (medium-sized firms), micro enterprises located at the bottom end of the pyramid are likely to benefit from sub-contracting activities of the former. This in turn will contribute to their (implicit) integration.
2. The access to information will encourage the unregistered MSMEs to register with the government in order to benefit from the programmes, trainings, etc. This will have a two-fold benefit. One, the erstwhile invisible firms will come to sight of the policy makers, improving their inclusiveness into the overall ecosystem and helping to address their challenges. Two, participation in formal economy will support their business through sub-contracted orders from the relatively larger firms. Earlier, the unregistered firms have reported loss of business as the larger firms chose to shift away due to loss of input credits under the value added tax reform on GST.

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